INTERNATIONAL ENERGY CREDIT ASSOCIATION

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July 1, 2019

Ms. Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
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Re: Federal Reserve System's Proposed Rule: *Netting Eligibility for Financial Institutions*, 84 Fed. Reg. 18741 (May 2, 2019), Docket No. R–1661, RIN 7100–AF 48

Ladies and Gentlemen:

The International Energy Credit Association ("IECA") appreciates the opportunity to comment on the Board's Proposed Rule.

The IECA is a global association of credit, risk management, legal and finance professionals that is dedicated to promoting the education and understanding of credit and other risk management-related issues in the energy industry. The IECA seeks to protect the rights and advance the interests of the physical energy companies that make up most of its membership, who use financial derivatives in energy commodities to help mitigate and manage energy commodity price volatility.

As the Board notes,

> Regulation EE expands the FDICIA definition of "financial institution"—and therefore expands FDICIA's netting protections—using an activities-based test that includes a qualitative component and a quantitative component. The qualitative component requires that the person "represent[ ], orally or in writing, that it will engage in financial contracts as a counterparty on both sides of one or more financial markets." A person that makes this representation demonstrates that it is willing to engage in transactions on both sides of the market and is, in effect, holding itself out as a market intermediary. The quantitative component requires that the person have either (1) one or more financial contracts of a total gross dollar value of at least $1 billion in notional principal amount outstanding on any day during the previous 15-month period with counterparties that are not its affiliates or (2) total gross mark-to-market positions of at least $100 million (aggregated across counterparties) in one or more financial contracts on any day during the previous 15-month period with counterparties that are not its affiliates.[1]

[1] 84 Fed. Reg. 18741 col. 3.

Many IECA member companies routinely enter into financial contracts when hedging long or short physical positions in energy commodities. By being able to make the representation that it qualifies as a "financial institution" pursuant to §231.3(a)(1) or (2) and satisfies the qualitative test,[2] a counterparty can avail itself of FDICIA's "certainty that netting contracts will be enforced, even in the event of the insolvency of one of the parties"[3] and "goals of reducing systemic risk and increasing efficiency in financial markets".[4]

Accordingly, the IECA has long promoted and sought to preserve the benefits of FDICIA for its members and other market participants. For example, in its comment letter submitted in response to the Commodity Futures Trading Commission's proposed rule on the End-User Exception to Mandatory Clearing of Swaps, the IECA noted that many counterparties in energy commodity physical and derivative transactions have represented in their master agreements that they are "financial institutions" as defined by the Board under Regulation EE, in order to ensure netting across over-the-counter derivatives between the parties. IECA asked the CFTC to clarify that a "financial institution" under FDICIA is not necessarily a "financial entity," which is a category of entities that cannot elect the "end-user exception" to clearing for purposes of the CFTC's rules regarding swaps. The CFTC did so in its Final Rule.[5]

The IECA concurs with the Board's statement that "Regulation EE does not expand the definition of 'financial institution' by rule to include institutions or individuals who are end users and not market intermediaries"[6], because its members have understood for two decades that the defined term "financial institution" already includes end users who are market intermediaries and that meet the qualitative[7] and quantitative tests set forth in the definition.

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[2] 84 Fed. Reg. 18741 col. 3, text at fn. 4.
[3] 84 Fed. Reg. 18741 col. 2, along with, as the Board notes, provisions of the Bankruptcy Code and Federal Deposit Insurance Act. 84 Fed. Reg. 18742 col. 1, fn. 8; 84 Fed. Reg. 18744 col. 3, fn. 44.
[4] 84 Fed. Reg. 18742 col. 2.
[5] The Commission noted that "'financial entity' and 'financial institution' are different terms referenced in different statutes. Interpreting the meaning and use of 'financial institution' under FDICIA is within the jurisdiction of the [FDIC]." CFTC, *End-User Exception to the Clearing Requirement for Swaps*, 77 Fed. Reg. 42561 cols. 2-3. (The CFTC may have intended to refer to the Federal Reserve Board rather than the FDIC, but either way, the message is clear that to the CFTC, "financial institution" is something different.)
[6] 84 Fed. Reg. 18741 col. 3.
[7] "The Board agrees that an institution that represents that it is willing to engage in transactions on both sides of the market is, in effect, holding itself out as a market intermediary. Accordingly, the Board has revised the language of the qualitative test to provide that such a representation would suffice to meet the test. The Board has eliminated that part of the proposed rule that would have required a financial institution to participate actively in a financial market for its own account. The Board believes that the revised final rule provides counterparties with greater certainty that an institution meets the qualitative test because counterparties can rely on the institution's representation." Board, Final Rule, *Netting Eligibility for Financial Institutions*, 59 Fed. Reg. 4780, 4782 col. 1 (Feb. 2, 1994).

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The IECA includes a FDICIA "financial institution" representation in its 2016 Master Netting Agreement form.[8] Documentation published by the Edison Electric Institute ("EEI") in connection with its form of Master Netting Agreement has informed those trading in energy commodities of the benefits of netting under FDICIA.[9] Commenters have long noted FDICIA's benefits for large active participants in the energy commodity and derivatives markets and other financial markets.[10]

The IECA also agrees that a qualifying central counterparty should be included as a category of entities that qualify as "financial institutions". The IECA does not propose any other modifications to the existing activities-based test and supports the Board's proposed rule as written.

Yours truly,
INTERNATIONAL ENERGY CREDIT ASSOCIATION

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[8] §4.1(c); avail. at https://www.ieca.net/node/736.
[9] *See* the 2003 *User Guide to the EEI Master Netting, Setoff, Security, and Collateral Agreement* ("MNSSCA"), which states: "If both counterparties to the Master Netting Agreement are "financial institutions" as defined in the FDIC Improvement Act of 1991 ("FDICIA"), they will want to select this option. As more fully described in the Legal Landscape, the FDICIA provides that a bilateral "netting contract" between two "financial institutions" is enforceable in accordance with such netting contract notwithstanding the financial failure of one of the financial institutions." Avail. at https://www.eei.org/resourcesandmedia/mastercontract/Documents/users_guide.pdf; *see also*, EEI, *Survey of the Legal Landscape Applicable to Master Netting Agreements* (Oct. 2002), which states "FDICIA provides that "financial institutions" can net payment obligations but does not impose the requirement that such payment obligations arise out of the same type of transaction, cross-product netting issues generally do not arise under FDICIA . . . ," avail. at https://www.eei.org/resourcesandmedia/mastercontract/Documents/survey.pdf.
[10] e.g., Jeremy Weinstein, *Master Netting Agreement Developments in the Energy Industry*, 23 Fut. & Derivs. L. Rep. 1 at p. 5 (May 2003); Brosterman, Cerria, Olsen, Speiser, & Szyfer, *Multilateral Netting Under Safe Harbor Contracts*, 10 Pratt's J. of Bankruptcy L. 129 (2015).

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